

**U.S. House of Representatives  
Energy and Commerce Committee  
Subcommittee on Energy and Air Quality  
February 16, 2005**

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**Executive Summary**

Natural gas demand has for several years been increasing more rapidly than our ability to produce more supply. The resultant tight market has exhibited higher and more volatile gas prices. Without aggressive action by government, this unstable situation will persist. Increasing the ability to produce domestic natural gas is necessary for economic growth and customer well being, and it can be compatible with environmental protection.

The Lower-48 has provided about 85 percent of the total U.S. gas supply in recent years. This percentage likely will decline over time, but it will continue to provide the majority of our natural gas for the foreseeable future. Increasing or even maintaining current Lower-48 production levels without increased land access is, at the very best, problematic. Maintaining natural gas production levels, and increasing them, will require increased land access in the Lower 48. Congress should review existing restrictions on land access to determine which remain truly necessary to protect environmental values given the considerable changes in exploration and production technology in the last twenty-five years. Congress should also enact provisions to streamline and expedite the various permitting processes and should authorize and appropriate adequate funding for the agencies charged with these responsibilities.

New sources of supply, including Alaska and imported liquefied natural gas (LNG), must also account for a larger share of our gas supply portfolio in the future. Congress last year took action to encourage Alaskan supply and should take additional action to encourage liquefied natural gas supply by codifying certain federal policies concerning open-access at marine LNG import terminals and reaffirming exclusive federal jurisdiction over LNG siting.

There is no question that additional natural gas supply will be necessary to meet America's needs. Doing so, however, is only one part of addressing our current energy situation. Bringing natural gas supply and demand into balance also requires that we devote resources and attention to promoting energy efficiency.

Although bringing additional gas supplies on-stream is a necessary action, it is not by itself sufficient to bring natural gas customers a complete solution to today's circumstances. Infrastructure to bring that natural gas to the customers who require it must also be constructed. Congress can facilitate this infrastructure expansion—which will require the energy industry to invest hundreds of billions of dollars—with several actions. First, Congress can take a number of actions to streamline the permitting process where federal agencies are involved. Second, Congress should also enact accelerated tax depreciation for distribution systems to ensure that ample infrastructure exists to meet the demand for natural gas.

AGA continues to believe that enactment of a comprehensive national energy policy is the optimal means to address the issues facing the natural gas industry. The nation needs a portfolio of energy sources, with each providing a resource for the applications to which it is best suited. No energy policy can, however, be both sound and

comprehensive unless it implements conservation and efficiency policies that are necessary to optimize the nation's use of its energy resources.

The November 18, 2003, conference report to the Energy Policy Act of 2003 includes an array of provisions that would help different forms of energy play their essential part in fueling the nation's homes and businesses, as well as provisions aimed at the important ends of conservation and efficiency. AGA appreciates this Committee's efforts to evaluate how the provisions of H.R. 6 might be updated to reflect events of the last year or more. In short, many of the provisions of H.R. 6 should be adopted. With, however, the passage of time, Congress needs to take additional steps to bring more gas supply to market.

## **The Gas Supply, Infrastructure and Efficiency Challenge**

My name is Laurence M. Downes. I am Chairman and Chief Executive Officer of New Jersey Resources, which operates a natural gas utility in New Jersey that provides service to more than 455,000 customers. I am also the Chairman of the American Gas Association (AGA), which represents approximately 200 local energy utility companies that deliver natural gas to more than 56 million homes, businesses and industries throughout the United States. Natural gas currently meets one-fourth of the United States' energy needs, and it is the fastest growing major energy source. As a result, adequate supplies of competitively priced natural gas are of critical importance to AGA and its member companies. Similarly, ample supplies of reasonably priced natural gas are of critical importance to the millions of customers that AGA members serve. AGA speaks for those customers as well as its member companies.

The natural gas industry is at a critical crossroads. Natural gas prices were relatively low and very stable for most of the 1980s and 1990s, largely as a result of ample supplies of natural gas. Wholesale natural gas prices during this period tended to fluctuate around \$2 per million Btus (MMBtu). But the balance between supply and demand has become very tight since then, and, therefore, even small changes in weather, economic activity, or world energy trends have resulted in significant wholesale natural gas price fluctuations.

Market conditions have changed significantly since the winter of 2000-2001. Today our industry no longer enjoys prodigious supply; rather, it treads a supply tightrope, bringing with it unpleasant and undesirable economic and political consequences—most importantly high prices and higher price volatility. Both

consequences strain natural gas customers—residential, commercial, industrial and electricity generators.

Since the beginning of 2003, the circumstances in which our industry finds itself have become plainly evident through significantly higher natural gas prices. Natural gas prices have consistently hovered in the range of \$5-6 or more per MMBtu in most wholesale markets. In some areas where pipeline transportation constraints exist, prices have skyrocketed for short periods of time to \$70 per MMBtu. Simply put, natural gas prices are high and volatile, and the marketplace is predicting that they will stay high. At this point there is no significant debate among analysts as to this state of affairs. Changing the current supply/demand balance requires continuing efforts aimed at energy efficiency as well as initiatives to provide more natural gas supply.

As this Committee well knows, energy is the lifeblood of our economy. More than 60 million Americans rely upon natural gas to heat their homes, and high prices are a serious drain on their pocketbooks. High, volatile natural gas prices also put America at a competitive disadvantage, cause plant closings, and idle workers. Directly or indirectly, natural gas is critical to every American.

The consensus of forecasters is that natural gas demand will increase steadily over the next two decades. This growth will occur because natural gas is the most environmentally friendly fossil fuel and is an economic, reliable, and homegrown source of energy. It is in the national interest that natural gas be available to serve the demands of the market. The federal government must address these issues and take prompt and appropriate steps to ensure that the nation has adequate supplies of natural gas at reasonable prices.

Many of the fields from which natural gas currently is being produced are mature. Over the last two decades, technological advances have greatly enhanced the ability to find natural gas as well as to produce the maximum amount possible from a field. While technology will undoubtedly continue to progress, technology alone will not be sufficient to maintain or increase our domestic production.

Today's tight natural gas markets have been a long time in coming, but there are still numerous unexploited sources of gas in the United States. We are not running out of natural gas; we are not running out of places to look for natural gas; we are running out of places where we are *allowed* to look for gas. The truth we must confront now is that, as a matter of policy, this country has chosen *not* to develop much of its natural gas resource base.

Without prudent elimination of some current restrictions on U.S. natural gas production, producers will struggle to increase, or even maintain current production levels in the Lower-48. This likely would expose 63 million homes, businesses, industries and electric-power generation plants that use natural gas to unnecessary levels of price volatility—thus harming the U.S. economy and threatening America's standard of living.

If America's needs for energy are to be met, there is no choice other than for exploration and production (E&P) activity to migrate into new, undeveloped areas. There is no question that the nation's natural gas resource base is rich and diverse. It is simply a matter of taking E&P activity to the many areas where we know natural gas exists. Regrettably, many of these areas—largely on federal lands—are either totally closed to exploration and development or are subject to so many restrictions that timely and economic development is not possible. As we contemplate taking these steps, it is

important that all understand that the E&P business is—again as a result of technological improvements—enormously more environmentally friendly today than it was 25 years ago. In short, restrictions on land access that have been in place for many years need to be reevaluated if we are to address the nation’s current and future energy needs.

This year, like the past several years, the most important step the entire Congress can take to address these pressing issues is to enact a comprehensive energy bill with provisions ensuring that lands where natural gas is believed to exist are available for environmentally sound exploration and development. Additionally, it is appropriate to create incentives to seek and produce this natural gas. These steps are necessary to help consumers and the economy.

The “Natural Gas Outlook to 2020” by the American Gas Foundation underscores all of these concerns. That study looks at anticipated natural gas demand and supply in the year 2020. The report expects that, if the nation continues on its present course, by 2020 natural gas prices will increase by 70 percent, reaching approximately \$13.76. This is anticipated to lead to increased unemployment, plant closings, and the movement of industrial operations overseas, just as it has in the last several years. It also indicates that, in two alternative policy scenarios (the “expanded” and the “expected”), customers can save annually \$200 billion or \$120 billion when compared to going forward on a *status quo* basis.

### **The Gas Demand Opportunity**

While it may seem unduly elementary, it is important to remember that the market relies upon two countervailing forces to operate: supply and demand. Price is determined by the intersection of the two, and volatility, which has become a challenge for all energy

stakeholders, is a result of the particular intersection of those two factors. As the discussion above notes, additional gas supply is both necessary and desirable. Nevertheless, we must continue to focus on the opportunities to serve the interests of customers presented by taking actions with regard to natural gas demand as well. In terms of the market and prices, a unit of natural gas not consumed is indistinguishable from a unit of natural gas produced and consumed. There clearly are opportunities for Congress to capitalize on this gas demand opportunity.

AGA is not, however, an advocate of government action that interferes with the operation of efficient markets. Nevertheless, there are opportunities where government policy can point the invisible hand in the right direction. There are at least three opportunities where government policy can allow us to capitalize on the demand opportunity. First, Congress can ensure that we as a nation utilize the best approach to our energy-efficiency analysis, by requiring that we look at efficiency on a full-fuel-cycle basis. Second, Congress can provide tax incentives for efficiency that require very modest public support but that will provide large efficiency gains. Third, we need to ensure that the interests of energy industry stakeholders are aligned with the goals of energy efficiency.

A brief summary of AGA's priorities in this regard is attached.



## **Increasing Domestic Natural Gas Supply**

**The most important step in sustaining and increasing domestic natural gas production would be to look, with an environmentally sound eye, to develop new natural gas frontiers within the United States.**

The United States possesses a resource base that is adequate for many more decades of energy production. Growth in production from this resource base is, however, jeopardized by limitations currently placed on access to it. For example, most of the gas resource base off the East and West Coasts of the U.S. and the Eastern Gulf of Mexico is currently closed to any exploration and production activity. Moreover, access to large portions of the Rocky Mountains is severely restricted. The potential for increased production of natural gas is severely constrained so long as these restrictions remain in place.

America is not running out of natural gas, and it is not running out of places to look for natural gas. America is running out of places where we are *allowed* to look for gas. The fields where we currently produce natural gas are mature. More and more effort is required to produce less and less gas with each well. Quite simply, there is no way, other than exploring for natural gas in new geographic areas, to meet America's anticipated demand for natural gas unless we turn increasingly to sources located outside North America.

**The existing universal prohibitions on all E&P activity on the East Coast, the West Coast Coast, and the Eastern Gulf of Mexico must be reevaluated with an objective, dispassionate eye to determine if these areas can be explored without adverse environmental consequences.**

A gigantic swath of federal lands, much of which is known to overlay large deposits of natural gas, has been placed off limits to any form of E&P activity, no matter how environmentally sound and sensitive. This blanket prohibition can no longer stand. The U.S. E&P industry has been transformed by technology over the last quarter century such that drilling for natural gas today is an entirely different venture compared to thirty or forty years ago. The nation's pressing need for energy to warm its homes and to supply its businesses mandates that we reevaluate this prohibition. A process must begin where individual offshore areas are evaluated to determine, with a dispassionate and objective eye, whether sound environmental stewardship continues to mandate the universal prohibition of E&P activity offshore under which we live today. AGA believes that such an analysis will reach the conclusion that some areas should remain off-limits, some areas should be made the subject of stringently controlled activity, and many areas can be safely explored with the latest environmentally friendly E&P techniques.

There are undoubtedly many avenues that could be followed to achieve this objective. AGA has recently reviewed the "SEACOR" proposal to restructure the current regulatory scheme for the offshore areas of the United States. That proposed legislative represents a sound and balanced means to begin the process of striking the environmental balances that the United States needs to undertake. Undoubtedly other proposals could harmonize the nation's energy needs with the protection of environmental values.

**An integrated, omnibus review of restrictions in the Intermountain West must be undertaken to harmonize and rationalize overlapping and duplicative restrictions that make many areas effectively closed to E&P activity.**

The Intermountain West has been, and is expected to continue to be, a growing supplier of natural gas. This can, however, only be the case if access to key prospects is not unduly impeded by stipulations and restrictions, which are often conflicting and overlapping. Two separate studies by the National Petroleum Council and the U.S. Department of the Interior have reached a similar conclusion—that nearly 40 percent of the gas resource base in the Intermountain West is restricted from development, in some cases partially and in some cases totally. On this issue, the Department of the Interior noted that there are nearly 1,000 different stipulations that can impede resource development on federal lands.

It is essential that energy needs be balanced with environmental impacts and that this evaluation be complete and up-to-date. Finding and producing natural gas is accomplished today through sophisticated technologies and methodologies that are cleaner, more efficient, and much more environmentally sound than those used in the 1970s. Many restrictions on natural gas production in the Intermountain West have simply not taken account of the important technological developments of the preceding thirty years. The result has been policies that deter and forestall increased usage of natural gas, which is, after all, the nation's most environmentally benign and cost-effective energy source.

Congress should mandate a from-the-ground-up review of the various restrictions and limitations applicable to federal lands in the West with the goal of rationalizing and harmonizing the restrictions and reviews currently involved.

**Adequate authorizations and appropriations are essential for the various federal permitting agencies to perform their functions responsibly, efficiently, and promptly.**

A number of federal agencies are charged with responsibility for reviewing and acting upon applications for permits for E&P activities. These include the Minerals Management Service, the Bureau of Land Management, the Fish & Wildlife Service, and Forest Service. AGA is aware of numerous instances where these agencies have not been able to perform their necessary functions in timely fashion simply for lack of fiscal resources. This represents an unnecessary and unwarranted barrier to sound energy and resource development. Fiscal resources that are miniscule in amount—when compared to the scope of so many federal programs—would, if applied here, provide major benefits for the nation’s energy customers. AGA respectfully requests that Congress authorize and appropriate sufficient funds for these agencies to undertake their functions responsibly and in a reasonable time frame.

**Streamlining and expediting permitting processes for E&P activities will assist in bringing forth additional natural gas supplies.**

There is no question that improvements can be made in the processes for permitting associated with natural gas E&P activities. The November 18, 2003, conference report for the Energy Policy Act of 2003 contains an array of provisions aimed at making permitting processes more efficient (*see, e.g.*, Sections 341-351). Enactment of these provisions by Congress would be a step toward increased natural gas production.

Similarly, a variety of provisions in Subtitle B of Title III would have the effect of improving the various administrative processes associated with E&P activities (*see, e.g.*,

Sections 312, 318, 319, 321, 322, 323, 325, 326, 327, 328, 329, 330). Enactment of these provisions would help bring forward additional natural gas supplies.

**Adopt reasonable production incentives and royalty relief provisions.**

Without question tax incentives can help achieve both objectives. Perhaps the most dramatic example is the Section 29 tax credit. The Section 29 tax credit brought forth coal-bed methane supplies in numerous parts of the country. Today, that supply accounts for approximately 10 percent of U.S. natural gas consumption. The conference report for the Energy Policy Act of 2003 contained an array of incentives. First, that bill contained a number of royalty-relief provisions. (*See, e.g.*, Title II, Subtitle B, Sections 311-316.) These provisions were aimed at encouraging the more difficult types of exploration and production activity. Second, the bill contained a number of tax incentives aimed at spurring production. (*See, e.g.*, Title XIII, Subtitle C, Sections 1341-1348.) These measures were aimed at improving the cash flow of smaller producers or providing an incentive for several more difficult types of production. Incentives of this type, if reasonable in nature, are a constructive component of a balanced, comprehensive energy plan.

It is often reported that the energy industry focuses unduly upon producing more fossil fuels. The implication, stated or unstated, is that doing so is harmful to the environment as well as the nation's quality of life. What is almost universally overlooked in these reports is that natural gas is the cleanest of the fossil fuels. When burned, natural gas emits virtually no sulfur dioxide or particulate matter and emits far lower levels of nitrogen oxides, carbon monoxides, carbon dioxide, and reactive hydrocarbons than either coal or gasoline. It is critically important to keep these environmentally friendly

characteristics of natural in mind when addressing the policy issues related to the production of natural gas.

As suggested above, the most important action that can be taken to bring new gas supplies to customers is opening to exploration and production the many areas throughout the United States that we know to contain significant natural gas resources. Many of these areas have been closed to exploration or have been made the subject of so many restrictions that they are *de facto* closed to exploration. At heart, these closures and restrictions are ostensibly grounded in environmental concerns. The nation needs to review these restrictions. Most importantly, it needs to review them with a contemporary view that reflects the fact that the exploration and production business is enormously more environmentally friendly today than was the case thirty or forty years ago. Equally importantly, these assessments must be made with an understanding of the importance of energy production to the nation, particularly as it bears upon economic prosperity and well being.

### **Increasing the Supply of Liquefied Natural Gas**

**LNG will be an important source of supply, and, it will, even in modest quantities, have a significant effect upon natural gas prices.**

Given the policy choices that the nation has previously made with regard to gas supply and with regard to land access, imported LNG will be an essential incremental supply of natural gas. Although several dozen such import projects have been announced, in all likelihood a far smaller number will actually be constructed. Even if only several projects are ultimately brought online, the impact of these imports upon U.S. natural gas prices will be material and significant. Accordingly, it would be sound policy for the

government to take whatever actions it can to facilitate the siting and construction of LNG marine import terminals.

**Congress should create certainty for LNG project developers by codifying FERC regulatory policy with regard to LNG and by reaffirming exclusive FERC jurisdiction over LNG import terminals.**

The current process for siting LNG import terminals—with appropriate applications being submitted to FERC—is working efficiently. Over the past decade and a half, FERC has materially improved its processes for approving energy infrastructure. There is no need at present to interfere with that process.

Congress can, however, give encouragement to LNG project developers by codifying current FERC regulatory policy, announced in FERC's *Hackberry* orders, that LNG import terminals will be treated as if they were natural gas producers and will not be made subject to the open-access requirements imposed upon interstate natural gas pipelines. Doing so will provide certainty that will assist in the development of these projects. (The November 18, 2003, conference report for the Energy Policy Act of 2003, in Section 320, proposes to do just that.)

Additionally, Congress can take important action to reaffirm that FERC has exclusive jurisdiction under Section 3 of the Natural Gas Act over the facilities for the importation of LNG into the United States. Doing so will remove a cloud of uncertainty spawned by the Public Utilities Commission of the State of California, which is currently being addressed by the courts in *Californians for Renewable Energy v. FERC*, No. 04-73650 (Ninth Circuit).

## **Increasing Natural Gas Infrastructure**

In the fall of 2005 Congress took the most important infrastructure action possible by approving the package of legislative provisions essential to spur construction of the Alaska natural gas transportation system. But further actions to this end are in order. Further actions, however, as suggested below, are in order.

**Reduce the depreciation period for new gas distribution lines from 20 to 15 years.** AGA anticipates that growing gas demand over the coming decades will require local natural gas utilities to construct approximately \$100 billion in new infrastructure. Congress should facilitate this essential infrastructure by enacting accelerated tax depreciation for local gas distribution companies. (This provision was included as Section 1322 of the conference report for the Energy Policy Act of 2003.)

**Adopt the infrastructure provisions contained in H.R. 6.** The conference report for the Energy Policy Act of 2003 contained a number of other worthwhile provisions that would assist in ensuring that adequate natural gas infrastructure is available to serve the nation's natural gas customers. (Sections 321, 325, 326, 330, 341, 346, 347, 348, 349, 350, and 351.)

**Improve federal permitting processes.** A widespread difficulty with infrastructure permitting is the multiple layers of review required as part of the permitting process, even though FERC is generally the lead agency in the licensing process. The conference report on the Energy Policy Act of 2003 attempted to address some of those difficulties by mandating one record to be relied upon (Section 330) and by requiring deadlines in Coastal Zone Management Act proceedings (Section 325). The infrastructure problem is, however, broader than this, and broader solutions are required.



A number of studies have documented the overlapping and conflicting review processes that are regularly involved in energy infrastructure permitting. At the federal level, the simple and elegant solution is to vest FERC with authority to oversee all ancillary permitting of interstate natural gas pipelines, whether state or federal, and to authorize it to require that ancillary reviews be undertaken within a time certain. These multiple layers of review are perhaps the largest roadblocks in terms of time for interstate natural gas infrastructure, and they without question add costs to infrastructure—costs that are ultimately borne by customers.

### **The Importance of Fuel Diversity and Energy Efficiency**

At present there is no significant ability to increase natural gas production in the very near term because production is essentially occurring at full capacity. In this context, additional demand—whether generated by weather or economic activity—produces great volatility in prices. In essence, in instances of additional demand the market rationalizes through price volatility.

In this context, only efficiency measures can, in the near term, moderate demand and, therefore, moderate prices. Market-driven conservation can have an impact in the short term, but true efficiency measures can only be effective in the longer term. Over the last twenty years, America's households have decreased their natural gas consumption 1% per year on average. Similarly, commercial and industrial concerns have made great strides in improving their efficiency. These trends will undoubtedly continue, but government can take steps to make quantum leaps in efficiency.

AGA strongly endorses addressing the nation's energy policy on a comprehensive basis, with energy efficiency playing an essential role. The conference report on the

Energy Policy Act of 2003 includes a large number of energy efficiency provisions, addressed not only to natural gas but also to almost all fuel sources. Congress should move forward with these provisions as an integral element of a comprehensive energy bill. These relatively modest provisions can pay enormous dividends in the longer haul.

AGA also believes that the nation should rely upon a full portfolio of energy sources to meet its energy needs. A balanced portfolio of energy sources is in the national interest.

**Adopt full fuel-cycle energy-efficiency analysis.** Moreover, energy policy should seek to put each fuel to its most effective use. Regrettably our energy policy today is not founded upon this principle. In most instances, for example, on a life-cycle basis and from the perspective of allocative efficiency, natural gas is most efficient in direct-flame applications—space heating, cooking, and water heating. On a life cycle, full-fuel-cycle basis, electricity generally is considerably less efficient for these uses. Thus, by ignoring this fundamental precept, our energy policy today misallocates resources. Energy policy would make a great step forward in this regard by performing its analysis on a full-fuel-cycle, full life-cycle basis.

Congress should move forward in this realignment of the nation's approach to energy efficiency. To make federal energy usage measurement accurate, Congress should direct the federal agencies that sponsor promotional and rating programs for energy-efficient appliances, homes, and buildings (*i.e.*, DOE, EPA Energy Star, etc.) to base those programs on total energy usage (in addition to measuring the energy usage at the site of consumption). All other things being equal, this shift would tend to shift gas

toward direct flame applications and somewhat away from consumption in generating peak electricity, resulting in a more efficient usage of the nation's resources.

**Adopt reasonable tax provisions that promote efficiency.** Similarly, tax credits can lead to more efficient energy consumption. The conference report on the Energy Policy Act contains a number of tax provisions seeking to promote this end. Provisions of this type play an essential part in a balanced, comprehensive energy proposal.

**Reliance on market forces.** AGA also believes that government policy should not seek to interfere in the market decisions that result in the nation's energy portfolio. High natural gas prices as we are experiencing at the moment tend to produce calls for energy allocation schemes (for example, suggestions that government policy should affirmatively discourage the use of natural gas in the generation of electricity). Past events should provide ample proof that such calls, if accepted, always produce new, unintended, and unforeseen deleterious consequences. AGA believes that the market, if left unhindered, will produce a diverse and robust energy portfolio for the nation.

**Encourage innovative gas utility regulatory structures that reward utilities for encouraging energy efficiency.** Additionally, from the perspective of AGA and its members, the goals of energy efficiency are often ill served by the rate and cost recovery mechanisms employed at the retail level by local natural gas utilities. More often than not utility rates are designed on a volumetric basis, where utility efforts to encourage efficiency and reduce natural gas consumption result in financial harm to the utility. These traditional rate mechanisms run counter to public policies regarding energy efficiency. This need not be the case. Recently several states have adopted innovative rate structures that align the utility's economic interests and the goals of energy efficiency.

Other state public utility commissions will soon be considering similar proposals. Adoption of these mechanisms should reduce natural gas consumption and reduce overall customer bills while allowing natural gas utilities to earn their authorized returns. Last year leading environmental and energy conservation organizations joined the American Gas Association in supporting such innovative gas utility proposals.

## **Summary and Conclusion**

These are challenging times in the natural gas industry. Natural gas prices are both high and volatile. Natural gas customers across America are counting on our leadership to bring them a solution. It lies in taking action in Washington that encourages a three-part assault on the problem:

- Taking the necessary steps to allow and stimulate natural gas exploration and production off the East Coast, off the West Coast, in the eastern Gulf of Mexico, and in the Intermountain West
- Taking the necessary steps to stimulate and expedite the expansion of our natural gas infrastructure to bring natural gas to those Americans who want and need it
- Taking the necessary steps to stimulate new advances in energy efficiency